United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

To Be Argued By
JACOB IMBERMAN

76-4112

United States Court of Appeals

FOR THE SECOND CIRCUIT

ESTATE OF LUDWIG NEUGASS, Deceased, HERBERT MARX, JACQUES COE, JR., and CHASE MANHATTAN BANK, N.A., Executors,

Petitioners-Appellants,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

ON APPEAL FROM A JUDGMENT OF THE UNITED STATES TAX COURT

BRIEF FOR PETITIONERS-APPELLANTS

PROSKAUER ROSE GOETZ & MENDELSOHN
Attorneys for petitioners-appellants
300 Park Avenue
New York, New York 10022
(212) 593-9000

Of Counsel
JACOB IMBERMAN
ALAN S. ROSENBERG
LAWRENCE J. ROTHENBERG
BENJAMIN L. GREENBERGER

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Statement of Issues

1. Where a testator provides in his will that, upon his death, testator's wife shall have a life estate in testator's artworks, or, in lieu thereof, may elect within six months of testator's death to take a fee simple in any or all of said artworks, is the fee simple which actually passed to the wife pursuant to her election made within the requisite period a "terminable interest" which does not qualify for the marital deduction under Section 2056(b) of the Internal Revenue Code?[1]

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[1] All statutory references hereinafter are to the Internal Revenue Code of 1954, as amended (26 U.S.C.), unless otherwise indicated. The relevant provisions thereof are reproduced in an Appendix to this Brief.

The court below, after finding that this bequest constituted a vested life estate with a power of appointment to expand that interest into a fee, answered this question in the affirmative.

2. Should a will granting the surviving spouse a life estate with the right to "elect" a fee be interpreted as having provided a simple choice between alternative bequests where the uncontroverted evidence demonstrates this to have been testator's specific intent?

The court below answered this question in the negative.

3. Where a testator grants his spouse an election between alternative bequests exercisable within six months of his death, does the interest passing to the spouse by virtue of her exercise of the election constitute a "terminable interest" under Section 2056(b)?

The court below did not answer this question.

Statement of the Case

Petitioners-appellants seek reversal of an order and decision (JA 147)[2] of the Tax Court (Featherston, J.) which approved a tax deficiency of $109,079.42 as determined by respondent-appellee.[3] This Court has jurisdiction to hear this appeal under 26 U.S.C. §7482.

The basic facts may be stated quite simply. In his will Ludwig Neugass granted his wife Carolyn a life use of all

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[2] References to the Joint Appendix are cited "JA."

[3] The Tax Court's opinion is reported at 65 T.C. 188 (1975). Subsequent references are to the opinion as reproduced in the Joint Appendix at JA 128-146.

his works of art, with the right to elect, within six months of his death, to take absolute ownership of any or all items in the collection. Mrs. Neugass exercised this right by executing a document within the requisite period whereby she elected to take absolute ownership in most of the items in her late husband's collection. The court below held that the artworks so passing to Mrs. Neugass do not qualify for the marital deduction, since, as of the moment of death, her interest in said items was "terminable". This conclusion is based on the finding that the will granted a vested life estate with a general power of appointment, which power was terminable under Section 2056(b)(5) of the Internal Revenue Code.

Petitioners-appellants, on the other hand, believe that a proper consideration of the evidence introduced concerning testator's intent and testamentary scheme, as well as an appreciation of the underlying purposes of the marital deduction, show that the testator intended, and indeed expressed his intent in the will, to leave his wife a simple choice between alternative bequests, and that the interest elected by Mrs. Neugass, being a nonterminable fee simple interest, should qualify for the marital deduction.

The legal issues this Court is called upon to decide touch matters of significance with regard to the enforcement of an important legislative policy: equalizing the estate tax impact between community property and non-community property states. Since Mrs. Neugass elected absolute ownership in the artworks for which the marital deduction is claimed, they will be fully taxed in her estate upon her death. If the deduction is denied in Mr. Neugass' estate, the result will be the imposition of a double tax on the same property in the same generation. This result

is directly counter to the purpose of the marital deduction provisions.

We submit that: (a) the evidence shows that the will provided Mrs. Neugass with an election between alternative bequests (Point I, *infra*); and (b) the interest chosen pursuant to said election should not be deemed a terminable interest (Point II, *infra*).

The Facts

The statement of facts jointly submitted below (JA 16) can be summarized as follows:

Ludwig Neugass died testate in New York City on February 24, 1969. Petitioners-appellants were thereafter issued letters testamentary by the Surrogate of New York County, New York. Mr. Neugass left surviving him his wife, Carolyn Neugass, his daughter, Nancy Carouso, and two grandchildren. The Neugass will, in relevant part, provides as follows:

> FIFTH: I direct that if my wife, CAROLYN NEUGASS, survives me, she shall have the life use of all my paintings and other works of art (hereinafter called my "collection"), without bond, and that upon her death my daughter, NANCY CAROUSO, if she is then living, shall have the life use of said collection, without bond.
>
> • • • • •
>
> With respect to any item in said collection:
>
> (a) Within six months after the date of my death, either my wife or my daughter may renounce her life use thereof and, if both of them so renounce, the item shall become the absolute property of the FOUNDATION.

> (b) Within six months after the date of my death, either my wife or my daughter may elect to take absolute ownership of any item, whereupon said item shall become the absolute property of my wife or my daughter; in the case of my daughter, such election shall take effect if and only when her life use has begun.[4]

Pursuant to these provisions, Mrs. Neugass renounced her life estate in those items she did not want (Exhibit 3, JA 41) and elected absolute ownership of the bulk of decedent's collection (Exhibit 2, JA 34). At the same time, decedent's daughter, Nancy Carouso, elected to take absolute ownership of those items over which her life estate had commenced as a result of Mrs. Neugass' partial renunciation.

In the Federal estate tax return filed by petitioners-appellants with the District Director of Internal Revenue in New York City on May 22, 1970, a marital deduction was claimed for the value of those items of decedent's art collection which Mrs. Neugass had elected to take absolutely. The deduction was denied by the Manhattan District Director of Internal Revenue because, in his opinion, the interest passing to Mrs. Neugass in decedent's artworks was a terminable interest. (JA 5)

After a trial in New York City on January 23, 1975 (JA 47-126), Judge Featherston denied petitioners-appellants' prayer for relief and granted respondent-appellee's prayer

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[4] The full texts of the will and codicil appear as Exhibit 1 at JA 20-33.

that the deficiency of $109,079.42 be approved, in an opinion dated October 29, 1975 (JA 128-146). The decision was entered January 22, 1976. (JA 147)

ARGUMENT

POINT I

Decedent's will granted his surviving spouse an election between alternative bequests.

The issue on appeal in this case is whether the bequest to the surviving spouse of the decedent's art collection, which passed in fee to the surviving spouse pursuant to an election between alternative bequests, qualified for the marital deduction. Appellants contend that the Tax Court erred in finding that the provisions of Article FIFTH of the decedent's will, which disposed of the decedent's art collection, did not constitute an alternative bequest.

Article FIFTH of the decedent's will directs that Mrs. Neugass ". . . shall have the life use of all of my paintings and other works of art . . ." and then goes on to provide in Paragraph (b) as follows:

> "(b) Within six months after the date of my death . . . my wife . . . may elect to take absolute ownership of any item . . ." (JA 22)

The Tax Court found that Mrs. Neugass acquired a life estate immediately upon testator's death and that her subsequent election to take a fee constituted an exercise of a "power" which enlarged an existing life estate to a fee. The Tax Court held that the bequest was not deductible

under Section 2056 of the Internal Revenue Code on the ground that it was a life estate coupled with a power of appointment, which power was terminable under the provisions of Section 2056 (b)(5). It is the appellants' position that the will granted Mrs. Neugass a choice between "alternative bequests", and that her election of a fee in decedent's art collection meant that there passed to her, from the decedent, a fee simple interest which qualified for the marital deduction.

A. *Decedent's intent was to grant his wife the maximum flexibility with respect to his art collection.*

In the proceeding below, appellant introduced uncontroverted testimony which indicated that the decedent wished to give his wife a choice between a fee simple and a life estate. (JA 75; JA 90) His intent was to afford his wife maximum flexibility in the types of interests she might choose to accept. (JA 74-75; JA 77-78; JA 86-87) Article FIFTH of decedent's will was drafted so as to assure this flexibility and to assure that decedent's wife would always have the alternative of absolute ownership.

At the time the will was drafted, New York law was unclear as to whether one could renounce from a greater to a lesser interest in the same legacy. It was also believed possible that an election of one of several alternatives would be interpreted as a renunciation of the alternative not chosen. It was therefore felt necessary to structure Mrs. Neugass' election in such a way that the alternative rejected was the lesser interest, not the greater; the renunciation, if it be so interpreted, would then be from a lesser to a greater interest rather than the questionable

converse. (JA 88-91) The election was limited to a six-month period after testator's death, since six months was the only known period within which a renunciation was then permissible. (JA 91-92)[5] Thus the form adopted gave to Mrs. Neugass the fullest flexibility consistent with New York law to choose a life estate or a fee.

B. ***The Tax Court erroneously failed to consider testator's intent, and then incorrectly interpreted his will.***

The will offered Mrs. Neugass the right "to take absolute ownership of any item . . ." of decedent's art collection. Nowhere is there any indication that the provisions with respect to the art collection are to be deemed a power of appointment. Indeed, the decedent, in Article SIXTH (d), provided for a marital deduction trust for his wife, *i.e.*, a life estate with a general testamentary power of appointment. (JA 23-24) The provisions of Article SIXTH (d), contrary to Article FIFTH, specifically use the words "appoint" and "power". Article FIFTH, on the other hand, is drafted solely in terms of an "election". Despite the foregoing, the Tax Court assumed that the right to elect and the right to exercise a power are one and the same thing. The sole basis for this assumption was a narrow reading of the will, pursuant to which the right to elect was construed as a power to expand an existing, limited estate to a broader, fee interest, and this power to enlarge was thereby deemed a power with a six-month time limitation fatal to

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[5] New York law required that renunciation of an intestate share be made within six months of death. N.Y. DEL §87-a.

the marital deduction. As we show below, however, at pages 24 to 26, the fact that an election results in an enlargement does not change its basic nature—it is still only an election.

Even if the Tax Court were correct in limiting its analysis to the four corners of the will, its conclusion would be mistaken. For the will specifically states that in the case of the *daughter's* right to elect a fee,[6] "such election shall take effect if and only when her life use has begun." The most basic rules of construction dictate that since this explicit limitation is directed only to the daughter's election, it does not apply to that of the wife, and Mrs. Neugass' right to elect is not limited to the period after her life estate has begun. Instead, she is to have a pure choice between two alternatives, with neither taking effect before her choice is made.

Faced with this clear evidence contrary to its conclusions, the Tax Court stated that the same directive made explicit in the case of the daughter must be deemed "implicit" in the case of the wife. But this assumption was clearly unwarranted, because the testator had only singled out his daughter's life estate in this regard.

In further support of its conclusions, the Tax Court turned to the renunciation (JA 41) and election (JA 34) documents executed by Mrs. Neugass, by which she renounced her life estate in some of the artwork given to her under the will and elected a fee in the rest. Significantly, in the document pursuant to which Mrs. Neugass elected the alternative of a fee, she did not renounce a life

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[6] The Will grants to decedent's daughter the same choice as to the wife between a life estate and a fee simple in any works of art disclaimed by the wife or over which the wife's life estate, if any, has terminated. (JA 22)

estate. This evidences a belief that there was no life estate existing in those items to which the election was applicable. Despite this, the Tax Court surprisingly reached the opposite conclusion and held (JA 137-138) that the election document indicated that Mrs. Neugass' life estate had begun as of the date of the testator's death.

Aside from this apparent misreading of the will and related documents, if the Tax Court would have been more receptive to the evidence introduced concerning testator's overall plan and intent, it would have been equally obvious to the Court that its assumptions and interpretations were incorrect.

C. *The Tax Court's approach to interpreting the will was improper.*

Rather than giving sympathetic consideration to the underlying reasons for the will's draftsmanship, the Tax Court took an extremely narrow and restrictive approach to interpreting the decedent's will. This is in marked contrast with a virtually identical evidentiary situation, in the context of the terminable interest rule, recently dealt with by this Circuit, wherein the Court held that extrinsic evidence was crucial in interpreting testamentary language.

In *Estate of Tilyou* v. *Commissioner,* 470 F.2d 693 (2d Cir. 1972), the Court was faced with interpreting an ambiguous phrase used by a testator in the context of the terminable interest rule. The Court looked to extrinsic evidence which indicated that the testator used the phrase in question because of uncertainties in New York law totally unrelated to the question of terminable interests. As in the instant case, in *Tilyou* a will was drafted, because of a testator's concern about effectiveness under local law, in

a manner which inadvertently raised an issue as to the availability of the marital deduction. Since the phrase in question was susceptible to various interpretations, one of which would qualify the bequest to the surviving spouse for the marital deduction, and since the testator did not intend to create a terminable interest but was motivated by entirely distinct concerns about the effects of unrelated local law, the Court in *Tilyou* found that the clause should not be read to create a terminable interest. As the Court stated, at 470 F.2d 699:

> "Given the uncertain impact of this phrase in New York law, the receptiveness of New York courts to extrinsic evidence to determine the circumstances known to the testator when he drew his will, and the substantially uncontroverted explanation of the reasons for including this clause in the will (which explanation clearly established that Francis S. Tilyou did not *intend* to create a terminable interest in his widow), we believe that the clause should not be read to create a terminable interest in this will." [emphasis in original]

Whether or not testator was *correct* in his assessment of the possible difficulties under local law which motivated his drafting is entirely irrelevant:

> "Whether or not Edward was correct in believing that the 'entitled to' clause was necessary to prevent intestacy, he clearly did not intend this clause to create a terminable interest . . . " [470 F.2d at 698]

The Tax Court's refusal in this case to consider the evidence introduced relating to testator's intent is apparently

based upon what it believed to be the mandate of *Jackson* v. *United States*, 376 U.S. 503 (1964), and *Allen* v. *United States*, 359 F.2d 151 (2d Cir. 1966), *cert. den.* 385 U.S. 832 (1966). (JA 142, n.8) The Tax Court failed to take note, however, of cases subsequent to *Jackson* and *Allen* which have significantly altered the strict approach advocated in those two opinions. Three years after *Jackson*, and after the *Allen* opinion was handed down, the United States Supreme Court, in *Northeastern Pennsylvania National Bank & Trust Co.* v. *United States*, 387 U.S. 213 (1967), significantly shifted its emphasis from strict adherence to the formalities of the marital deduction rules to an overriding concern for the fulfillment of the underlying purpose of those rules:

> "Congress' intent to afford a liberal 'estate-splitting' possibility to married couples, where the deductible half of the decedent's estate would ultimately—if not consumed—be taxable in the estate of the survivor, is unmistakable." [387 U.S. at 221]

This readiness on the part of the Supreme Court to look beyond the formalities imposed by the statute to an analysis of the specific testamentary disposition in relation to the underlying purpose of the statute represents a profound departure from the strict approach of *Jackson*. As the dissent in *Northeastern* pointed out, "[o]f even greater importance is the sharp change of attitude toward the marital deduction which today's decision heralds." (387 U.S. at 229) If the gift bequeathed to the wife will in fact be taxed in her estate, the Court will seek to interpret the gift, if in any way possible, in a manner which will permit a find-

ing of compliance with the marital deduction rules, since the statute's purpose will then have been achieved.[7]

The *Tilyou* case represents a proper application of the approach taken in *Northeastern*. While recognizing the admonitions of *Jackson* and *Allen* concerning strict adherence to the formalities of the marital deduction rules, the *Tilyou* court took note as well of the liberal emphasis of the *Northeastern* decision, and proceeded to find in favor of the taxpayer based upon its analysis of the evidence submitted concerning the testator's intent in using the language there in question.

Further evidence of the emerging trend in favor of a more liberal attitude toward the marital deduction, and a greater receptiveness toward indicia of testator's intent in construing language which might otherwise run afoul of the marital deduction statute, is *Estate of Mittleman* v. *Commissioner*, 522 F.2d 132 (D.C. Cir. 1975). The *Mittleman* court criticized the Tax Court for not considering testamentary intent in its interpretation of ambiguous language:

> "We think the Tax Court erred in its decision, primarily because of the limited scope of its inquiry. The court probed no deeper than the bare language of the ninth paragraph of the will, and grounded its interpretation of that paragraph on what it took to be 'the plain terms of' that provision. Had the court delved further and considered additional manifesta-

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[7] The *Allen* decision concedes this underlying statutory purpose:

> " . . . while the terminable interest rule is, indeed, a thicket, the Congressional purpose in disqualifying terminable bequests was certainly not to elevate form above substance. It was, instead, to prevent the wholesale evasion of estate taxes . . . " [359 F.2d at 154]

tions of testamentary intent, it would have been readily apparent that the terms of paragraph nine were not nearly as plain as at first blush they might seem to be, and that other factors speak more eloquently than the testator's pen." [522 F.2d at 136]

The Court of Appeals specifically pointed to the testimony of decedent's attorney, who testified that he advised decedent that in his opinion the will as drafted would qualify for the marital deduction, and concluded therefrom that decedent's intent to qualify the gift for the marital deduction "could hardly be clearer." In summarizing its approach toward the interpretation of testamentary language in connection with the marital deduction, the Court succinctly stated:

> "As the Supreme Court has observed 'Congress' intent to afford a liberal "estate-splitting" possibility to married couples, where the deductible half of the decedent's estate would ultimately—if not consumed—be taxable in the estate of the survivor, is unmistakable.' So, in interpreting a will ostensibly within this policy, courts should give due weight to the testator's desire to secure the marital deduction. We recognize that the mere intention to garner a tax benefit is not decisive, or even necessarily relevant, in deciding whether a deduction is available. We hold, however, that where a testator intends to create a trust qualifying for the marital deduction, ambiguities in his will should, if possible, be resolved in favor of success in that endeavor." [522 F.2d at 140]

The same approach should be followed in the instant case. As the *Mittleman* Court observed, " . . . other factors

speak more eloquently than the testator's pen." The alternative bequest provided for in the Neugass will would clearly qualify for the marital deduction had it not been obscured by a draftsman's endeavor to prevent New York law from defeating the testator's intent. A proper consideration of the testator's intent and his overall testamentary scheme removes the obscurity and clearly reveals the unequivocal plan to convey full ownership in the disputed assets to Mrs. Neugass. These are the circumstances for which the marital deduction was created. Proper construction of the will would compel the allowance of the deduction in this case. Decedent desired to give his wife a choice between two alternatives. The will was drafted as it was because of unrelated uncertainties concerning New York law, but as this Court held in *Tilyou,* that fact should not obscure the intended effect of the language used. Since Mrs. Neugass' estate will in fact be taxed on the value of the artworks she elected to take in fee, the purposes of the marital deduction would not be defeated by allowing the artworks to escape taxation in the husband's estate; as pointed out in *Northeastern,* it is this purpose which must be the governing consideration.

Furthermore, in this case as in *Mittleman,* evidence was introduced below (JA 76, 79) showing that the testator inquired as to the availability of the marital deduction and was advised by counsel, as was the decedent in *Mittleman,* that the deduction would be available. This evidence regarding testator's desire to qualify his gift to his wife for the marital deduction should weigh heavily in the Court's interpretation of otherwise ambiguous testamentary language. In view of the Tax Court's refusal to take any of these factors into consideration, we submit that the inter-

pretation of the will arrived at by the Tax Court was incorrect and should be reversed by this Court.[8]

D. *New York law recognizes the validity of alternative bequests.*

The Tax Court never dealt with the validity of alternative bequests under New York law, since it erroneously assumed that it was dealing with a life estate with a power of appointment. The Tax Court indicates that the appellant provided no evidence of the existence of alternative bequests as a concept in New York law separate and apart from a power of appointment. This, however, is not the case.

New York Courts have consistently recognized the validity of bequests in alternative form. An example of this may be found in *Matter of Jacobsen,* 61 Misc. 2d 317, 306 N.Y.S. 2d 290 (Surr. Ct., N.Y. Co. 1969), *aff'd,* 33 App. Div. 2d 760, 306 N.Y.S. 2d 297 (1st Dept. 1969), which presented a factual situation almost identical to that in this case. In *Jacobsen,* the testators' will provided two alternative provisions for his widow, with the proviso that she would be presumed conclusively to have chosen the first alternative unless she were to choose the second alternative within six months. The second was a bequest in trust designed to preclude the spouse's right to elect to take against the will. The widow nevertheless claimed the right to elect against the will, arguing that the second alternative was conditional

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[8] An appeals court may properly reconstrue a written instrument for itself, in spite of a finding on that question below, since the construction of written documents is a question of law, not fact. *Commissioner* v. *Buck,* 120 F.2d 775, 779, (2d Cir. 1941); *Mittleman, supra,* at 141, n. 63.

and therefore not an "absolute disposition" as required by N.Y. EPTL §5-1.1 (McKinney 1967).

The Court rejected the widow's claim, holding that the mere requirement of choosing one of two alternatives did not make the second alternative bequest conditional. In effect, the Court sanctioned the use of alternative bequests. The Court specifically said:

> ". . . she has the free choice of the two alternatives, with no burden other than to say what she wants." [61 Misc. 2d at 320; 206 N.Y.S. 2d at 293]

An earlier New York case, reaching the same conclusion under similar facts, is *Matter of Williamson*, N.Y.L.J., Jan. 23, 1942, p. 347, col. 6 (Foley, S.).

As has been shown, the testator's sole purpose in granting Mrs. Neugass an election between a life estate and an absolute fee was to provide her with an unfettered choice between the alternatives. Where such is the case, New York has specifically recognized the validity of alternative bequests within the will as a proper vehicle for insuring that such flexibility will be available to the spouse. In *Matter of Flyer*, 53 Misc. 2d 476, 279 N.Y.S. 2d 76 (Surr. Ct., Kings Co. 1967), for example, the Court states:

> "And when he provided that if his wife is 'dissatisfied with the provision made for her hereunder' or 'refuses to accept the provision made hereunder' she shall be entitled to her 'statutory share of my estate', he *intended to give his wife a choice* to take the benefits of the trust provision or her intestate share . . . , and she was not required to serve and file a notice of

election therefor under §18 of the Decedent Estate Law." [53 Misc. 2d at 478; 279 N.Y.S. 2d at 78; emphasis supplied.]

The Court in *Flyer* did not require that a statutory notice of election be filed in order to take the second alternative, since it regarded the second alternative as a valid alternative bequest rather than a statutory right of election against the will.

It is therefore clear that New York Courts have sanctioned the use of alternative bequests and that Article FIFTH of the will in this case is in fact a disposition of the testator's art collection to his wife in the form of alternative bequests.

POINT II

The interest acquired by the surviving spouse pursuant to the exercise of an election qualified for the marital deduction.

If the Court adopts the interpretation urged by appellants, it will find that decedent gave his wife a choice between two alternative gifts. The only act required of Mrs. Neugass was that she signify her desire to elect the fee simple in all or any of her husband's artworks within six months of his death. The issue then becomes whether the requirement that Mrs. Neugass affirmatively elect a fee simple converts an otherwise nonterminable interest into a terminable interest.

A. *Testamentary elections may qualify for the marital deduction.*

In the only case appellants have found specifically on point on this question, *Estate of George C. Mackie,* 64 T.C. 308 (1975), Judge Tannenwald held that a gift acquired by the surviving spouse pursuant to an election granted to her under the will, would not be considered a terminable interest even though the election was exercisable only within four months of testator's death. In *Mackie,* the will provided that:

> "My said wife shall have, however, the right to elect whether to accept this devise, bequest and appointment, or to reject it, or to accept it in part and reject it in part, which election she shall make by a statement in writing to that effect delivered to my executrix within four months from the date of my death. The failure of my said wife to deliver such statement to my executrix within such time shall be deemed an election by her to reject this devise, bequest and appointment in full." [64 T.C. at 309]

The Court held that:

> ". . . at the time of death, Mrs. Mackie became entitled to a vested indefeasible interest in the bequest and . . . the requirement of election or rejection on her part was nothing more than a method whereby her right to that interest was to be perfected." [64 T.C. at 310-11]

The mere fact that Mrs. Mackie had to elect to accept the gift did not introduce any contingencies into the bequest which would make it terminable, even though the election

was exercisable only within four months of death. The Tax Court in the instant case distinguished *Mackie* solely on the basis of its predetermined interpretation of the Neugass will as having granted a power of appointment to expand an already vested life estate into a fee rather than a choice between alternatives (JA 141-142). If the will is now properly construed as having granted alternative bequests, the *Mackie* case becomes indistinguishable from the instant case and its principles should be applied.[9]

The underlying premise of the *Mackie* opinion is that there should be no difference between elections granted by the terms of a will and elections granted by state law, such as the widow's right to elect against a will. In the latter instance, it has consistently been held that the interest taken by the widow when she elects against a will is not a terminable interest, even though she must affirmatively indicate her election, and usually within a limited time period. *See, e.g., Hamilton National Bank of Knoxville* v. *United States,* 353 F.2d 930 (6th Cir. 1965), *cert. den.,* 384 U.S. 939 (1966); *Estate of Green* v. *United States,* 441 F.2d 303 (6th Cir. 1971). The mere fact that she might not elect within the requisite time is not perceived as a terminable contingency. As the government conceded in its brief in the *Jackson* case:

> "Where under state law, a widow obtains a fixed right to claim a non-terminable interest at her husband's death, the mere procedural requirement that the widow signify her election or file her claim—which she might do immediately—does not make the interest meaning-

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[9] Even if the right to elect given to Mrs. Neugass is interpreted as a right to enlarge, this should not distinguish the instant case from *Mackie,* since *Mackie* similarly involved an enlargement from a life estate to a fee. *See infra,* pp. 24-26.

> fully contingent. Her election to take the interest is therefore deemed to relate back to the date of the decedent's death, and the marital deduction is permitted with respect to the property actually passing or vesting." [as cited in *Hawaiian Trust Company* v. *United States*, 412 F.2d 1313, 1314 (Ct. Cl. 1969)]

When the widow indicates her election, the marital deduction rules are satisfied so long as the interest actually passing to the widow is nonterminable, such as a fee simple.[10]

While it has been recognized since the *Jackson* decision that the proper moment from which to analyze the terminability of the interest passing to the spouse is as of the time of death, at which time the widow has not yet made her choice and could conceivably fail to do so within the allowable period, the interest actually chosen is neverthe-

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[10] This can be seen by the overall framework of the marital deduction scheme with respect to elections. Congress obviously meant to allow the deductibility of elective shares, and thus included in §2056(e), under subdivision (3), dower, curtesy and statutory interests in lieu thereof, as meeting the requirement of passing from the decedent. However, there is no comparable provision on elective shares with respect to terminability, since Congress obviously did not feel that an election in and of itself mandated a finding of terminability. This is the clear import of the legislative history of §2056(e):

> "Under subparagraph (c) of Section 812(e)(3) [now Section 2056(e)(3)], the dower or curtesy interest of the surviving spouse (or statutory interest in lieu thereof) is defined as an interest passing from the decedent. If such interest is a terminable interest, such as a life estate, the marital deduction would nevertheless be disallowed under subparagraph (b) of Section 812(e)(1) [now Section 2056(b)(1)]." [H.R. Rep. No. 1274, 80th Cong., 2d Sess. (1948), cited in 1948-1 C.B. 337.]

If, on the other hand, the interest passing to the spouse is itself *not* a terminable life estate, but a fee, the deduction should not be disallowed. *See also* Rev. Rul. 72-7, 1972-1 Cum. Bul. 308.

less not considered terminable unless it is "meaningfully" contingent. The necessity of compliance by the widow with procedural formalities is not considered such a contingency.

The Commissioner has explicitly recognized this principle in a recent Revenue Ruling published on May 3, 1976, Rev. Rul. 76-166, 1976 Int. Rev. Bull. No. 18, at 17. The Ruling involves the Arizona exempt property allowance and allowance in lieu of homestead. In spite of the fact that Arizona law requires that these interests be accepted by the widow by filing a petition in court, the interest so accepted was held to be nonterminable:

> "Where otherwise vested under state law, a surviving spouse's statutory property interest in a decedent's estate is not a terminable interest merely because the surviving spouse is required to affirmatively signify acceptance by formal legal action pursuant to the requirements of applicable local law or because the spouse may die prior to acceptance. Although the statutory property interests may terminate or fail upon the death of the spouse within 120 hours after the death of the decedent, the interests will not be considered terminable interests by reason of section 2056 (b)(3) of the Code.
>
> Thus, the aforementioned statutes do not impose any substantial conditions or limitation which would impinge on the surviving spouse's unqualified right to take unconditional ownership of the prescribed allowances." [at 18][11]

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[11] A similar theory exists with regard to the payment to the widow of insurance proceeds. The Commissioner in his Regulations provides as follows:

> "A contract which otherwise requires the insurer to make annual or more frequent payments to the surviving spouse fol-

The *Mackie* Court held that these principles are equally applicable where the election is made under the terms of the will; as the Court observed, "[w]e perceive this to be a difference without a distinction." (64 T.C. at 312) Since the widow was given an unfettered choice between accepting or rejecting the bequest, her act of choosing is not deemed to have introduced a terminable contingency, so long as the interest accepted is itself nonterminable.

In the instant case, Mrs. Neugass' election involves a choice between two alternative gifts rather than between accepting or rejecting a single gift. This too, however, may be deemed a "difference without a distinction." In either event, the widow must perform but one act; she must simply indicate her choice. This compliance with the formalities of the will as a means of perfecting her interest in the gift she chooses should not be deemed a terminable interest, just as it was not in the *Mackie* case.

The Commissioner's own Regulations support the conclusion that the act of election *under a will* does not introduce a terminable contingency. As one illustration of a method of valuing an interest passing to the surviving spouse for purposes of the marital deduction, we find the following:

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lowing the decedent's death, will not be disqualified merely because the surviving spouse must comply with certain formalities in order to obtain the first payment . . . [such as where the policy] requires the surviving spouse to furnish proof of death before the first payment is made." Treas. Reg. §20.2056(b)-6(d).

Thus, while the terminable interest rule, if taken literally, would disqualify surance proceeds, since the widow might not file proof of mere formalities are not deemed to have created contingenc

> "A decedent bequeathed certain securities to his wife in lieu of her interest in property held by them as community property under the law of the State of their residence. The wife elected to relinquish her community property interest and to take the bequest. For the purpose of the marital deduction, the value of the bequest is to be reduced by the value of the community property interest relinquished by the wife." Treas. Reg. §20.2056(b)-4, Example (3).

There is no question raised in this example about the availability of the marital deduction, even though the widow must affirmatively elect under the will which of two interests she will take. The only issue is the valuation of the interest actually passing to her.

In the instant case, the application of the above principles requires that the Court find in favor of the appellants. The only act required of Mrs. Neugass was that she elect whether she wished to accept a life estate or a fee simple in decedent's artworks. Since she in fact chose a nonterminable fee simple, the necessity of complying with the formality of an election does not make the otherwise nonterminable interest so passing to her terminable.

B. ***An enlargement of an interest may properly be characterized as an election.***

It is appellants' position, as argued above (Point I, *supra*), that the decedent's will granted his wife a choice between alternative bequests, rather than a vested life estate with a power to enlarge her interest to a fee. It is crucial to the Tax Court's reasoning that if, indeed, Mrs. Neugass was given a right to enlarge her preexisting interest, such

a right cannot be deemed a non-terminable election. Appellants maintain that even if this Court finds that Mrs. Neugass was given the right to enlarge her interest, such a right is still to be construed more properly as having given her, upon her exercise of that right, a non-terminable interest.

In the *Mackie* case, Item Nine of the will gave Mrs. Mackie the right to choose whether to accept or reject an outright gift of certain of decedent's property. If Mrs. Mackie would not have elected to take outright ownership of those items, Item Nine instructs that she shall be presumed to have rejected the gift, and the items rejected are then to pass into the residuary estate. But the residue is in turn bequeathed, in Item Twelve of the will, to a trust in which Mrs. Mackie is given a life interest (64 T.C. at 309-10). Thus, in effect, a failure by Mrs. Mackie to elect absolute ownership would result in her receiving a life estate in those very same items she rejected under Item Nine. The facts in *Mackie* are thus identical to those in the instant case, and yet, Judge Tannenwald in *Mackie* did not characterize the interest actually passing to Mrs. Mackie as terminable because it was an enlargement of a life estate to a fee. Instead, he held that property actually passing to Mrs. Mackie constituted a non-terminable interest which qualifies for the marital deduction, calling her right under the will, not one of enlargement, but of election. Judge Featherston's attempt to distinguish *Mackie* from the instant case by noting that the Neugass will involved an enlargement from a life estate to a fee (JA 141-142) therefore would appear to be a misunderstanding of the factual underpinnings of the *Mackie* decision.

Similarly, in *Estate of Green* v. *United States,* 441 F.2d 303 (6th Cir. 1971), the will left the surviving spouse a life interest in a residuary trust consisting of decedent's entire probate estate. The wife elected instead to take absolute ownership in her statutory share. In *Green,* as in the instant case, the widow rejected a life estate in all of decedent's specified property in favor of absolute ownership in some of those very same items. The Court in *Green* nevertheless found that the items passing to the wife qualified for the marital deduction.

From the foregoing, it is clear that the Court below erred both in its interpretation of the *Mackie* case and in its view of the applicable law relating to elections. Even on its own interpretation of the facts, the Court's opinion should be reversed as an improper application of statutory intent, since the court concedes that Mrs. Neugass had at least the equivalent of the options available to Mrs. Mackie. The Court goes on to strike down the marital deduction for Mrs. Neugass because of *additional* rights which it found were granted to Mrs. Neugass. This type of elevation of form over substance is precisely the approach to the marital deduction rejected by the courts in *Northeastern, Tilyou* and *Mittleman, supra.* As recognized by the court in *Tilyou,* it is this type of approach which should not be inflicted upon testators in this Circuit.

In addition to having incorrectly applied the law of elections, the court below, in dealing with the *Mackie* opinion, which we have shown is squarely on point with this case, neglected to deal with the basic holding of *Mackie,* and instead drew a factual distinction which did not exist. For both its improper application of the law, and its improper finding of a nonexistent factual distinction with the *Mackie* case, the decision below should be reversed.

CONCLUSION

The order and decision of the Tax Court (Featherston, J.) should be reversed with directions to grant petitioners-appellants' prayer for relief and to enter an order eliminating the deficiency of $109,079.42 assessed against petitioners-appellants.

Dated: New York, New York
June 30, 1976.

Respectfully submitted,

PROSKAUER ROSE GOETZ & MENDELSOHN
Attorneys for petitioners-appellants
300 Park Avenue
New York, New York 10022
(212) 593-9000

Of Counsel
JACOB IMBERMAN
ALAN S. ROSENBERG
LAWRENCE J. ROTHENBERG
BENJAMIN L. GREENBERGER

APPENDIX

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.)

Sec. 2056. Bequests, etc., to Surviving Spouse.

(a) Allowance of Marital Deduction.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsections (b), (c), and (d), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

(b) Limitation in the Case of Life Estate or Other Terminable Interest.—

(1) General Rule.—Where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed under this section with respect to such interest—

(A) if an interest in such property passes or has passed (for less than adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse); and

(B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse;

and no deduction shall be allowed with respect to such interest (even if such deduction is not disallowed under subparagraphs (A) and (B))—

(C) if such interest is to be acquired for the surviving spouse, pursuant to directions of the decedent, by his executor or by the trustee of a trust.

For purposes of this paragraph, an interest shall not be considered as an interest which will terminate or fail merely because it is the ownership of a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity for life or for a term.

* * * * *

(3) INTEREST OF SPOUSE CONDITIONAL ON SURVIVAL FOR LIMITED PERIOD.—For purposes of this subsection, an interest passing to the surviving spouse shall not be considered as an interest which will terminate or fail on the death of such spouse if—

(A) such death will cause a termination or failure of such interest only if it occurs within a period not exceeding 6 months after the decedent's death, or only if it occurs as a result of a common disaster resulting in the death of the decedent and the surviving spouse, or only if it occurs in the case of either such event; and

(B) such termination or failure does not in fact occur.

(4) VALUATION OF INTEREST PASSING TO SURVIVING SPOUSE.—In determining for purposes of subsection (a) the value of any interest in property passing to the surviving spouse for which a deduction is allowed by this section—

(A) there shall be taken into account the effect which the tax imposed by section 2001, or any estate, succession, legacy, or inheritance tax, has on the net value to the surviving spouse of such interest; and

(B) where such interest or property is encumbered in any manner, or where the surviving spouse incurs any obligation imposed by the decedent with respect to the passing of such interest, such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to such spouse of such interest were being determined.

(5) LIFE ESTATE WITH POWER OF APPOINTMENT IN SURVIVING SPOUSE.—In the case of an interest in property passing from the decedent, if his surviving spouse is entitled for life to all the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest, or such specific portion (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the interest, or such specific portion, to any person other than the surviving spouse—

(A) the interest or such portion thereof so passing shall, for purposes of subsection (a), be considered as passing to the surviving spouse, and

(B) no part of the interest so passing shall, for purposes of paragraph (1)(A), be considered as passing to any person other than the surviving spouse.

This paragraph shall apply only if such power in the surviving spouse to appoint the entire interest, or such specific portion thereof, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

(e) DEFINITION.—For purposes of this section, an interest in property shall be considered as passing from the decedent to any person if and only if—

(1) such interest is bequeathed or devised to such person by the decedent;

(2) such interest is inherited by such person from the decedent;

(3) such interest is the dower or curtesy interest or statutory interest in lieu thereof) of such person as surviving spouse of the decedent;

(4) such interest has been transferred to such person by the decedent at any time;

(5) such interest was, at the time of the decedent's death, held by such person and the decedent (or by them and any other person) in joint ownership with right of survivorship;

(6) the decedent had a power (either alone or in conjunction with any person) to appoint such interest and if he appoints or has appointed such interest to such person, or if such person takes such interest in default on the release or nonexercise of such power; or

(7) such interest consists of proceeds of insurance on the life of the decedent receivable by such person.

Except as provided in paragraph (5) or (6) of subsection (b), where at the time of the decedent's death it is not possible to ascertain the particular person or persons to whom an interest in property may pass from the decedent, such interest shall, for purposes of subparagraphs (A) and (B) of subsection (b)(1), be considered as passing from the decedent to a person other than the surviving spouse.

C 321—Affidavit of Service of Papers by Mail.
Affirmation of Service by Mail on Reverse Side.

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

Index No. 76-4112

Estate of LUDWIG NEUGASS, deceased, HERBERT MARX, JACQUES COE, JR. and CHASE MANHATTAN BANK, N.A., Executors,

Petitioners-Appellants

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee

AFFIDAVIT OF SERVICE BY MAIL

STATE OF NEW YORK, COUNTY OF NEW YORK *ss.:*

The undersigned being duly sworn, deposes and says:

Deponent is not a party to the action, is over 18 years of age and resides at

1 Treetop Lane, Monsey, New York 10952

That on the 30th day of June, *19* 76 *deponent served the annexed* Petitioners-Appellants' Brief and Joint Appendix on Scott P. Crampton, Assistant Attorney General, Tax Division, U.S. Department of Justice, *attorney(s) for* Respondent-Appellee *in this action at* U.S. Department of Justice, Washington, D.C. 20530 *the address designated by said attorney(s) for that purpose by depositing a true copy of same enclosed in a postpaid properly addressed wrapper, in—a post office—official depository under the exclusive care and custody of the United States Postal Service within the State of New York.*

Sworn to before me 30th day of June, 1976.

Adele J. Doyle

ADELE J. DOYLE
NOTARY PUBLIC, State of New York
No. 43-4511284 - Qual. in Richmond Co.
Cert. filed in New York County
Commission Expires March 30, 1977

Benjamin L. Greenberger

The name signed must be printed beneath
BENJAMIN L. GREENBERGER